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## CURRENT SUPPORT BRIEF

FINANCING OF COMMUNIST CHINA'S FOREIGN TRADE: MID-YEAR OUTLOOK

OFFICE OF RESEARCH AND REPORTS

CENTRAL INTELLIGENCE AGENCY

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CHINESE COMMUNISTS' FOREIGN TRADE FINANCING: MID-YEAR OUTLOOK <sup>2</sup>

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FINANCING OF COMMUNIST CHINA'S FOREIGN TRADE: MID-YEAR OUTLOOK

Communist China's response to the rapid deterioration of its balance of payment position since mid-1960 has involved a delicate juggling of its international financial resources. China's extreme financial stringency stems largely from poor harvests which have drastically curtailed the agricultural products available for export while also necessitating large-scale grain imports. The measures undertaken by the Chinese to avoid depletion of their foreign exchange reserves appear to be effective, but despite these efforts, Peiping probably will have to draw on reserves--including gold assets--in the magnitude of \$55-80 million to balance 1961 Free World accounts.

China's basic need in 1961 is to generate funds to pay for grain imports while maintaining a level of foreign exchange reserves sufficient for contingencies, and a level of imports of essential commodities, such as petroleum and fertilizers, sufficient for the operation of the economy. On the basis of current contracts, China's foreign exchange costs, including freight, for 1961 grain imports amount to an estimated \$350 million, of which about \$230 million is payable this year. China's first series of wheat imports, contracted before March 1961 and amounting to about \$160 million, were on cash basis, probably reflecting an estimate by the Chinese of what they would be able to finance without adverse effects on other programs. As the prospects of a third poor wheat crop became apparent, additional grain imports became necessary for the second half of the year, but credits were required to finance the purchases. The second series of grain contracts total about \$190 million, an estimated \$120 million of which will be under credits falling due in 1962.

The basic and probably most difficult response of the Chinese to their financial difficulties has been to slash imports radically--a response which impinges on development plans. The limited evidence on Sino-Soviet trade plans for 1961 suggests that the level of trade probably will decline nearly one-third from last year's level of about \$1.7 billion, and Chinese imports from the USSR may fall by as much as 40 percent. The Chinese have cut imports from Western Europe to such an extent that preliminary returns suggest this trade may be balanced this year, in contrast to the usual Chinese import surplus, which in recent years has been as high as \$220-270 million. Substantial sales of silver bullion have helped reduce the deficit. The Chinese appear to be retaining a high degree of flexibility in many of their trade commitments, probably in order to be able to adjust imports continuously to the availability of exports.

The Chinese are trying to maximize foreign exchange earnings by maintaining large export surpluses with a few areas, particularly Hong Kong, in order to generate the bulk of the Western exchange needed to pay for grain. China's net earnings with these areas probably will total at least \$100-125 million. Foreign currency remittances from overseas Chinese, which amounted to an estimated \$55 million in 1960, are being encouraged, but the available evidence suggests a drop this year to perhaps \$50 million, largely because some overseas Chinese are sending food parcels instead of money. Peiping's plan to encourage the overseas Chinese to lend money for fertilizer has not been to successful so far. Other measures, such as small, short-term borrowings from Hong Kong banks, possible limitations on external travel, and perhaps reduction of commercial staffs abroad yield only small sums of foreign exchange.

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By mid-1961, the Chinese appeared to be falling short of financing their grain imports from current export earnings by about \$55-80 million. A drain on China's reserves of this magnitude, while much less than the estimated \$140 million for 1960, would still be substantial. Moreover, this projected drain of reserves may be optimistic if the observed difficulties the Chinese are having in meeting export commitments turn out to be more than isolated examples.

The tight financial situation makes it likely that the Chinese will exploit whatever bargaining devices they have available to ease their position for the rest of this year, as well as 1962. With Australia and Canada they are apt to link further grain purchases to acceptance of Chinese goods or to extended credit terms. As a last resort, China might be willing to seek a long-term loan from the USSR, but only if faced with a considerable deterioration in its balance of payments with the West.

The Chinese have made painful adjustments which probably will enable them to meet their financial obligations in 1960. Their apparent success, however, has been achieved by postponing some payments until 1962. The Chinese may even be able to postpone until 1963 the payments associated with some wheat imports if the import surplus and quantity and credit terms of wheat purchases in 1962 are no worse than 1961. The gain in time, however, will require more delicate juggling, for the Chinese face a continuing and probably increasingly stringent financial situation with diminishing reserves.

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